

REPORT OF THE AUDITOR-GENERAL TO THE NORTH WEST PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE TLOKWE CITY COUNCIL FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Tlokwe City Council which comprise the statement of financial position as at 30 June 2009, the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages xx to xx.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance the Statements of Generally Recognised Accounting Practice (Statements of GRAP) and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Tlokwe City Council in this respect will be limited to reporting on non-compliance with this disclosure requirement.

Basis for disclaimer of opinion

Corresponding figures

5. In the previous financial year, I was unable to obtain sufficient appropriate audit evidence to determine the existence, rights and obligations, completeness and valuation and allocation of assets of R388 849 260, liabilities of R13 456 373 and accumulated funds and reserves of R334 336 958 as disclosed in the financial statements. My opinion on the financial statements for the period ended 30 June 2008 was modified accordingly. My opinion on the current period financial statements is also modified because of the possible effect of these matters on the comparability of the current period figures and the corresponding figures.

Property, plant and equipment

6. The existence, rights and obligations, completeness and valuation and allocation of property, plant and equipment of R353 939 107 presented in the statement of financial position was not confirmed. The asset register did not comply with paragraphs 38, 39, 53, 61, 71 and 73 of the Standard of Generally Recognised Accounting Practice, GRAP 17 *Property, plant and equipment* in terms of the unbundling of assets. I was unable to practicably quantify the misstatements and

could not perform alternative procedures due to a lack of sufficient appropriate supporting documentation which will only be available on completion of the unbundling exercise.

Provisions

7. The basis of calculation used to determine the provision for rehabilitation of refuse landfill-site of R2 509 404 as disclosed in note 17 to the financial statements was not be provided by management. The valuation, completeness and allocation of the provision were not confirmed. No alternative procedures could be performed due to scope limitation to quantify the possible effects on the financial statements.

Accumulated surplus

8. I did not obtain all the information and sufficient appropriate audit evidence I consider necessary to determine the valuation and allocation of the accumulated surplus of R386 084 416 as disclosed in the statement of changes in net assets, due to the following.
9. The following transactions as disclosed in the statement of changes in net assets are all related to reserve accounting which is not in line with the Standards of Generally Recognised Accounting Practice, GRAP 1: *Presentation of financial statements*.

Transfer to Capital Replacement Reserve	52 250 968
Property, Plant and Equipment purchased	54 820
Donated / Contributed PPE	524 497
Grants utilised to obtain PPE	25 061 681
Contribution to Insurance Reserve	1 479 100
Insurance claims processed	(899 015)
Offsetting of Depreciation	(31 937 815)

10. The net amount of R11 847 244 disclosed as "Net gains/(losses) not recognised in the Statement of Financial Performance" in the statement of changes in net asset differs with R25 641 825 from the net amount of R37 489 068 as per the corresponding general ledger account. Management did not provide sufficient appropriate audit evidence for transactions of R5 854 186 included in this net amount of R37 489 068.
11. The abovementioned net amount of R37 489 068 as per the general ledger account include debits of R6 075 266 and credits of R7 051 007 which should have been accounted in the Statement of Financial Performance as per the Standards of Generally Recognised Accounting Practice, GRAP 1: *Presentation of financial statements*, resulting in "Net gains/(losses) not recognised in the Statement of Financial Performance" being overstated and the surplus for the year in the Statement of Financial Performance being understated by R975 741.

Receivables

12. Management did not appropriately consider the impairment of consumer debtors based on objective evidence as per paragraph 58 and 59 of IAS 39 (AC 133): *Financial instruments: Recognition and measurement*, due to their calculation effectively only impairing debtors older than 180 days by an average percentage whilst the normal expectation is for user accounts to be paid within 30 days. As the municipality's records did not permit the application of alternative audit procedures, I was unable to reliably determine the valuation and allocation and completeness of the provision for impairment of R72 637 190 disclosed in note 3 to the financial statements.
13. The South African Statement of Generally Accepted Accounting Practise, IAS39 *Financial instruments: Recognition and measurement* requires that the subsequent measurement of financial assets (loans and receivables) of an entity be measured at amortised cost using the effective interest method. As disclosed in note 3 to the financial statements, included in consumer debtors of R175 374 496, is an account "Arrangements" of R10 871 972 for debtors who were granted extended payment terms. These debtors' accounts were not measured using the effective interest method. Had these debtors been measured using an interest rate

of prime interest rate plus 4.5% (the rate the municipality use for arrears debt) the consumer debtors and the net surplus for the year would have decreased by R5 980 788.

Government grants and subsidies

14. The amounts disclosed as current year receipts (R26 233 314) and conditions met (expenditure of R24 712 715) for conditional grants in notes 24.1 to 24.22 is incorrect. By way of alternative procedures I determined these actual amounts to be current year receipts of R44 108 835 and conditions met (expenditure) of R46 062 122.
15. GAMAP 9: *Revenue* determines that a conditional grant is only recognised as revenue when there is compliance with the conditions attached to it. The municipality however did not recognise any revenue for these conditional grants, resulting in government grants and subsidies received in the Statement of Financial Performance being understated by the actual conditional grant expenditure of R46 062 122 as reported above.

Unauthorised, irregular and fruitless and wasteful expenditure

16. In the previous financial year, unauthorised expenditure of R6 671 662 was not disclosed in the financial statements. My opinion on the financial statements for the period ended 30 June 2008 was modified accordingly. My opinion on the current period financial statements is also modified because of the possible effect of these matters on the comparability of the current period figures and the corresponding figures.
17. Contrary to section 125(2)(d) of the MFMA, the municipality did not disclose particulars of the following unauthorised and irregular expenditure in the notes to the financial statements.
18. Unauthorised expenditure of R8 473 418 regarding the overspending of the budgeted amounts in the following departments:
 - Budget and Treasury Office overspent with R476 103.
 - Office of the Executive Mayor overspent with R7 809 034.
 - Local Economic Development overspent with R188 281.
19. Contrary to MFMA Circular No. 29 dated 31 January 2006, bids were awarded to contractors by using predetermined cost estimates as a threshold in the final evaluation process. The total of R24 428 794 regarding these contracts is regarded as irregular expenditure.
20. Regulation 12 of the supply chain management regulations requires that written quotations be obtained for all procurement of goods and services between R10 000 and R200 000 and for all procurement above R200 000 a competitive bidding process should be followed. These practices were not followed in expenditure incurred amounting to R6 841 156 which is regarded as irregular expenditure.

Cash flow statement

21. The information and reconciliation to support the following disclosures in the cash flow statement was not provided by management:
 - Accumulated surplus of R33 967 565, included in cash flows from financing activities.
 - Non cash flow items of R11 185 562 included in the calculation of cash generated from operations of R33 156 582.
 - Non cash flow items of R25 952 309 recognised in the statement of financial performance not included in the calculation of cash generated from operations of R33 156 582.

The municipality's records did not permit the application of alternative procedures. Consequently I was unable to satisfy myself as to the accuracy, completeness and presentation and disclosure of the cash flow statement.

Disclaimer of opinion

22. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Other matters

I draw attention to the following matters that relates to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

23. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 Presentation of Financial Statements. The supplementary budget information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

24. Municipal Finance Management Act, 2003 (Act 56 of 2003)
- Contrary to section 32, the accounting officer did not manage unauthorised expenditure as prescribed.
 - Contrary to section 54(1)(f), the Mayor did not timeously submit a mid year budget and performance assessment report to council.
 - Contrary to section 64(3), 78 organs of state debtors were identified with outstanding debt of 30 days and older to the amount of R3 228 246 as at 30 June 2009.
 - Contrary to section 65(2)(e), creditors were not paid within 30 days.
25. Local Government: Municipal Systems Act, 2000 (Act No.32 of 2000)
- Contrary to section 104, the municipality did not have a fraud prevention plan.
 - Contrary to paragraph 12A of schedule 1, two councillors had consumer accounts outstanding for longer than 90 days as disclosed in note 30.6 to the financial statements.

Governance framework

26. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below.

Internal control deficiencies

27. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
5	Corresponding figures	5				
6	Property, plant and equipment	5		4	1	
7	Provisions	5				
8-11	Accumulated surplus	5	2		1	
12-13	Receivables	5	5	4		
14-15	Government grants and subsidies	5	2			
16-20	Unauthorised, irregular and fruitless and wasteful	5		6		

	expenditure					
21	Cash flow statement	5	2			

28. The abovementioned audit findings are mainly due to a lack of action plans to address recurring audit findings, the inability of the accounting division to ensure compliance with the accounting standards and a lack of effective document management to support the disclosures in the financial statements.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the	1

effectiveness of internal control over financial reporting.	
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

29. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		N
Quality of financial statements and related management information			
2	The financial statements were not subject to any material amendments resulting from the audit.		N
3	The annual report was submitted for consideration prior to the tabling of the auditor's report.	Y	
Timeliness of financial statements and management information			
4	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.		N
Availability of key officials during audit			
5	Key officials were available throughout the audit process.	Y	
Development and compliance with risk management, effective internal control and governance practices			
6	Audit committee		
	The municipality had an audit committee in operation throughout the financial year.	Y	
	The audit committee operates in accordance with approved, written terms of reference.	Y	
	The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		N
7	Internal audit		
	The municipality had an internal audit function in operation throughout the financial year.	Y	
	The internal audit function operates in terms of an approved internal audit plan.		N
	The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		N
8	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		N
9	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		N
10	The information systems were appropriate to facilitate the preparation of the financial statements.		N
11	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.		N
12	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	Y	
Follow-up of audit findings			
13	The prior year audit findings have been substantially addressed.		N
14	SCOPA/Oversight resolutions have been substantially implemented.		N/A
Issues relating to the reporting of performance information			
15	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		N
16	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		N

17	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Tlokwe City Council against its mandate, predetermined objectives, outputs, indicators and targets section 68 of the MFMA.	Y	
18	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		N

30. The main root causes for not achieving these key governance responsibilities are mainly due to a lack of effective leadership and supervision by the administrative leadership and audit committee to monitor the financial management and internal audit functions.

Investigations

31. An investigation by an independent consulting firm was conducted on request of the council on certain allegations regarding the previous Municipal Manager. The investigation was still ongoing at the reporting date.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

32. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

33. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

34. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
35. In terms of the foregoing my engagement included performing procedures to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
36. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Findings on performance information

Performance information not received in time

37. An assessment could not be performed of the reliability of the reported performance information, as set out on pages xx to xx of the annual report, since the information was not received in time for audit purposes.

Existence and functioning of a performance audit committee

38. The municipality did not appoint or budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

39. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required by section 45 of the MSA.

Lack of adoption or implementation of a performance management system

40. The municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

APPRECIATION

41. The assistance rendered by the staff of the Tlokwe City Council during the audit is sincerely appreciated.

Auditor-General

Rustenburg

25/01/2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence